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The Chandler Act-Its Effect Upon the Law of Bankruptcy

Cover Page Footnote

Class of 1940, Fordham University, School of Law

THE CHANDLER ACT—ITS EFFECT UPON THE LAW OF BANKRUPTCY¹

VINCENT L. LEIBELL, JR.†

History and Development of Bankruptcy Law

Legal historians unanimously agree that the fundamental concept of bankruptcy law is not a new one. In fact it is conceded to be of very ancient origin. But the exact time and place of its nativity has been the subject of much conjecture.

Perhaps a long-forgotten king of Babylon was the first to espouse the principle of debtor release.² Or possibly the credit should go to the ancient Israelites.³ Yet again the renowned Athenian sage, Solon, whose name has become synonymous for a wise legislator, may well have first planted the seed of bankruptcy law.⁴

Interesting as it may be to speculate on the time of its origin, those who deal with the practical side of bankruptcy law have been content to place its source in Roman Jurisprudence.⁵ Prior to the time of Julius Caesar insolvency was looked upon as a crime calling for severe punishment.⁶ The *Cessio Bonorum* modified the penalties inflicted on the debtor by permitting him to make an assignment of his property for the benefit of creditors. Said assignment operated as a release of debts only to the extent of the property surrendered. But it definitely mitigated his unhappy lot by exempting him from imprisonment.⁷

We must pass over many centuries from the time of the Roman Conqueror to the reign of King Henry VIII to find the immediate ancestor of our modern streamlined bankruptcy law. The first English Bankruptcy Act appeared on the statute books in the year 1542, under the significant title of An Act Against Such Persons As Do Make Bankrupts.⁸ Applying only to traders, a condition retained down to the days of Victoria,⁹ the Act dealt solely with fraudulent debtors. This being so, naturally no provision providing for release from debts was included. Perhaps the most important clause in the Act is the

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1. Class of 1911 Prize Essay.

The Class of 1911, on the occasion of its Silver Jubilee, established a prize consisting of the yearly income of the sum of \$1500, to be awarded annually for the best essay submitted by a student in the senior class of the Law School on a legal subject to be designated annually by the Dean. In the event that in any year no essay submitted is deemed worthy of the award, the income of the fund for that year will be devoted to the purchase of books for the law library.

2. Otterbourg, *BANKRUPTCY ANCIENT AND MODERN* (1938) 4.

3. 1 REMINGTON, *BANKRUPTCY* (4th ed. 1934) 2.

4. See note 2 *supra*.

5. 8 C. J. S. 412; 75 F. (2d) 947, 952 (C. C. A. 4th, 1935).

6. 1 REMINGTON, *BANKRUPTCY* (4th ed. 1934) 3.

7. BOUVIER'S *LAW DICTIONARY* (8th ed., 1914) *Cessio Bonorum*.

8. 34 & 35 HENRY VIII, c. 4.

9. 186 U. S. 181, 184 (1902); 4 Wheat. 122, 195 (U. S. 1819); 216 U. S. 449, 454 (1910).

following, "that is to say, to every of the said creditors, a portion rate and rate like, according to the quantity of their debts."¹⁰ No longer did the law favor the creditor who first might arrive on the scene and make off with the debtor's effects. For the first time the assets, such as they might be, were to be distributed pro rata. This indeed was a valuable contribution to the substance of bankruptcy law.

In 1570 during the reign of Queen Elizabeth the Parliament passed the second of the English Bankruptcy Acts.¹¹ This law enlarged and made more specific the Act of Henry VIII listing as it did certain offenses which would subject the debtor to punishment. Remington in his admirable work on bankruptcy, holds that these offenses "constituted what would now be denominated acts of bankruptcy."¹² Here again no provision was made for granting the bankrupt a complete discharge.

Weathering a few minor changes, the English law of bankruptcy remained substantially the same down to the reign of Queen Anne. In 1705 a radical departure was made from the then well established principle of "let the debtor beware", when the English Parliament, for the first time in modern history, provided for discharge of the debtor from his remaining debts, on condition that he comply with certain requirements set forth in the Act.¹³ Since Queen Anne's Act every bankruptcy law has contained a provision granting debtor relief, though the necessary prerequisites have varied considerably.¹⁴

Thus when the American Colonies declared their independence from the rule of King George III in 1776, English bankruptcy legislation provided not only for the pro rata distribution of the debtor's assets, but it also permitted the debtor's discharge from remaining debts in certain limited situations. However, many years were to pass before the scope of bankruptcy law would be broadened so as to include other than traders or to permit the initiation of voluntary proceedings by the debtor.¹⁵ At this point, coinciding as it does with the Declaration of Independence, we will cross the Atlantic and follow the development of bankruptcy law in the United States.

Article 1, Section 8 of the United States Constitution provides that "Congress shall have power . . . to establish . . . uniform laws on the subject of bankruptcies throughout the United States." This succinct statement has time and again been referred to by our courts in upholding the legality of the various bankruptcy laws passed since the Constitution was ratified in 1787. In the absence of Congressional legislation on the subject of bankruptcy, states have the power to pass insolvency laws. This power is very definitely a limited one, for the Constitutional provision against impairment of contracts by the states prevents the application of such insolvency laws to debts or obligations con-

10. See note 8 *supra*.

11. 13 Eliz. Ch. 7 (1570).

12. 1 REMINGTON, BANKRUPTCY (4th ed., 1934) 10.

13. 4 Anne Ch. 17.

14. 165 Fed. 588, 590 (C. C. A. 5th, 1908).

15. 298 U. S. 513, 535 (1936).

tracted prior to the date of enactment.¹⁶ Furthermore no state insolvency law may discharge a debtor from obligations owing to creditors of other states, unless by voluntarily submitting they grant the state jurisdiction over them. When Congress enacts bankruptcy legislation all state insolvency laws are suspended to the extent of actual conflict with it.¹⁷

The power of Congress to enact bankruptcy legislation lay dormant until the year 1800.¹⁸ The immediate cause of the first Bankruptcy Act was the depression of 1798. In this it differed not from its successors, for all of our national bankruptcy acts have followed closely upon economic depressions.¹⁹

The Bankruptcy Act of 1800 was restricted by its own terms to five years. It survived a little over three years. The vote of 99 to 13 for repeal in the House of Representatives is indicative of its unpopularity.²⁰ The Act itself followed rather closely the English law of the time, differing principally in the fact that it was made available not only to traders but also to merchants, underwriters, and brokers.

Mr. Justice Livingston, in 1817, expressed doubt as to the constitutionality of the extension of the law so as to include other than traders.²¹ In later years this doubt was overcome and subsequent bankruptcy acts were made available to additional classes of persons.²²

It was not until 1841, after public sentiment had crystalized as a result of the financial panic of 1837, that the second of our national bankruptcy acts was forced through Congress. The opposition protested most strongly against that section which permitted voluntary bankruptcies. Representative Trumbull arguing against its inclusion said, "Voluntary bankruptcy is a new term. Who ever heard such language before? Under this bill discharge of the debtor is the thing principally aimed at. Under previous acts, surrender of property was the chief object."²³ Apparently Congress was none too sympathetic to the proposed bill and it was only after skillful political maneuvering by Henry Clay on behalf of the Whigs that passage was secured.²⁴

The Act itself made a court of bankruptcy available for the first time to bankers, factors, and marine insurers. Already we may note the gradual extension of the operation of bankruptcy law so as to include new classes of debtors. Indeed "the discharge of the debtor has come to be an object of no less concern than the distribution of his property."²⁵ Progressive and workable though it was, this, our second national bankruptcy act, was short lived. In

16. U. S. CONST. ACT. I, § 10; 4 Wheat. 122, 191 (U. S. 1819); 298 U. S. 513, 531 (1936).

17. 245 U. S. 605, 613 (1917).

18. Bankruptcy Act of 1800.

19. 295 U. S. 555, 581 (1935).

20. WARREN, BANKRUPTCY IN U. S. HISTORY 19.

21. 1 Fed. Cas. No. 66 (C. C. N. Y. 1817).

22. 298 U. S. 513, 535 (1936); 185 U. S. 181, 184 (1901); 295 U. S. 555, 587 (1935).

23. WARREN, BANKRUPTCY IN U. S. HISTORY 72.

24. *Id.* at 76, 77.

25. 295 U. S. 555, 588 (1935).

less than two years from the time it was enacted it was repealed, falling during the turbulent days of the States' Rights controversy.²⁶

It was not until a quarter of a century after the repeal of the Bankruptcy Act of 1841, that Congress passed another bankruptcy law. The severe financial convulsion resulting from the Civil War was the immediate cause of its enactment. The Bankruptcy Act of 1867 survived until the year 1878. It was in no sense a model law. Remington justifiably criticises the Act because,

"It was too easy to throw a debtor into bankruptcy and too hard for him to obtain his discharge after he once became bankrupt, there were so many grounds named in the Act for declaring a debtor bankrupt, and so many for preventing his discharge."²⁷

Among the objections to the law was one that had been leveled against all its predecessors, this being the distance that the Federal Courts were located from many debtors, claimants, and witnesses.²⁸ When we recall the nature of transportation in the nineteenth century, it is apparent that the objection carried much weight. Another serious evil was the "most vicious fee system."²⁹ Creditors of small estates received nothing, while the assets of large estates were seriously depleted by excessive charges.

Before passing on to the Bankruptcy Act of 1898, we should take note of the inception of a new provision in American bankruptcy law. Embodied in the form of an amendment to the Act of 1867, Congress in 1874 provided for compositions. As can readily be understood, grave doubts were expressed as to the amendment's constitutionality. Here indeed was a new and important change. It was not until 1881 that the Supreme Court in the case of *Wilmot v. Mudge*, recognized the constitutionality of compositions.³⁰ Our bankruptcy law was coming of age.

The Bankruptcy Act of 1898

Twenty years after the repeal of the Bankruptcy Act of 1867, Congress enacted the Bankruptcy Act of 1898. Though often amended during the past forty-two years it is still the law of the land. Even the famous Chandler Act is no more than the most recent revision of the Act of 1898.

Passage of the Act, following in the wake of the financial debacle of 1893, was secured only after a long and strenuous Congressional struggle. Southern Congressmen felt that a bankruptcy law was a tool of Wall Street used by creditors of the North to beat down the debtor class of the South.³¹ To alleviate some of this prejudice, farmers and wage earners were specifically exempted from being adjudged involuntary bankrupts.³²

No attempt will be made at this point to give a detailed outline of the Act

26. 1 REMINGTON, BANKRUPTCY (4th ed. 1934) 15.

27. *Id.* at 16.

28. 114 Fed. 222, 224 (W. D. Miss. 1902).

29. 114 Fed. 222, 224 (1902); 174 Fed. 634, 637 (C. C. A. 2d, 1909).

30. 103 U. S. 217 (1880).

31. WARREN, BANKRUPTCY IN U. S. HISTORY 135-139.

32. Bankruptcy Act of 1898, § 4b, 11 U. S. C. 22.

itself, because in discussing the Chandler Act, the subject of this paper, much would of necessity have to be repeated. It will suffice to indicate the major defects of former bankruptcy laws which Congress tried to overcome in this Act.

The oft-repeated and justifiable charge that the federal courts were too far away for most of the people interested in bankruptcy proceedings was met with a provision for at least one referee for each county.³³

"The oppressive and expensive features"³⁴ of former acts were substantially mitigated by provisions limiting the compensation of those who performed duties for the court. Remington comments that,

"Indeed the whole spirit of the Act of 1898 breathes economy in administration and makes of this law a peculiarly business law."³⁵

Salutary as the economy provisions are, one cannot feel but that there is, even at this late date, room for further improvement.

It will be recalled that under the Bankruptcy Act of 1867, it was not difficult to find a reason to force a debtor into bankruptcy, but it was exceedingly difficult for the debtor once adjudicated to obtain his discharge. Congress in the Bankruptcy Act of 1898 very wisely limited the number of Acts of Bankruptcy³⁷ and the grounds for denying a discharge.³⁸

No list of improvements brought about by the Bankruptcy Act of 1898 would be complete without reference to the new definition of insolvency promulgated by Congress.³⁹ No longer could a debtor be thrown into bankruptcy because of his inability to meet his obligations as they matured. The test, henceforth, would be whether or not his assets, at a fair valuation, should be found to be less than his liabilities. Thus a temporary stringency in the money market could not be seized upon by creditors to cause the bankruptcy of debtors, who if they could readily liquidate their holdings, would be found to be solvent.

Prior to the passage of the Chandler Act the Bankruptcy Act of 1898 had been amended on numerous occasions. Space will not permit a complete discussion of these amendments. Generally speaking, they expanded the concept of bankruptcy administration. For example, in 1910 corporations were permitted to file voluntary petitions in bankruptcy.⁴⁰ Then on March 3, 1933, the last day of the Hoover Administration, a section was inserted in the Act providing for the reorganization of railroads engaged in interstate commerce.⁴¹ This was

33. Bankruptcy Act of 1898, § 34, 11 U. S. C. 62.

34. 114 Fed. 222 (W. D. Miss. 1902).

35. Bankruptcy Act of 1898, § 40, 11 U. S. C. 68. *See also* 19 F. Supp. 120, 122 (E. D. Ky. 1937).

36. 1 REMINGTON, BANKRUPTCY (4th ed. 1934) 17.

37. Bankruptcy Act of 1898, § 3a, 11 U. S. C. 21.

38. Bankruptcy Act of 1898, § 14b, 11 U. S. C. 32.

39. Bankruptcy Act of 1898, § 1, sub. 15, 11 U. S. C. 1.

40. Bankruptcy Act of 1898, §4a, 11 U. S. C. 22.

41. Bankruptcy Act of 1898, § 77, 11 U. S. C. 205.

followed in the next year by the enactment of the famous Section 77B, which remedied many of the defects of the old equity receivership system.

Pausing at this point, before proceeding into our study of the Chandler Act, and looking back over the past history of bankruptcy legislation, we observe that this phase of the law has not remained static but rather has been dynamic and responsive to the needs of the time. A progressive liberalization both on the part of the legislatures and of the courts has changed a system of law conceived in the theory that bankruptcy is a crime to one where compositions and creditor control have risen to the point of paramount importance. Rehabilitation not wanton destruction, has become the keynote of bankruptcy legislation.

Origin and Purpose of The Chandler Act

Unlike much recent legislation, the Chandler Act was not the result of any sudden pressure or desire to meet an emergency. When it was finally presented to Congress, it had behind it years of research and discussion. In the words of its sponsor, "It is a composite, representing a consensus of men thoroughly familiar with the subject, and approaching the problems presented from every viewpoint—the court and its administrative officers, the bar, the creditor, the debtor, the public, the law-text writer, the law-school instructor, and the economist."⁴²

Soon after the amendments of 1926 were enacted, many suggested a further revision of the law. It was urged among other things, that a modernization providing for prompter administration and limitations on creditor control would be to the interest of all concerned.⁴³

In 1929 as a result of certain indictments handed up by a grand jury investigating bankruptcy frauds, a searching inquiry conducted by Judge Thacher of the Southern District of New York, was begun.

In 1930, after Judge Thacher had become Solicitor General of the United States, the Department of Justice made a comprehensive survey of the situation pursuant to a Presidential Order of July 29, 1940.

The report of the Department of Justice, dated December 5, 1931, recommended that measures be taken designed: "1—to make the Bankruptcy Act more effective as a medium of distribution; 2—to make the discharge provisions of the law just and effective; 3—to discover fraud and waste; and 4—to secure more perfect administration."⁴⁴

The Hastings-Michener Bill, introduced in Congress in April of 1932, attempted to give effect to these recommendations. Apparently, there were two objections that carried such weight as to lead to the Bill's rejection. These were the fear "that it might build up a bureaucracy whose inefficiency might equal the inefficiency of the weak spots of the existing system,"⁴⁵ and that a complete

42. H. R. No. 1409, 75th Cong., 1st Sess. (1937) 3.

43. *Id.* at 2.

44. *Ibid.*

45. *Hearings before Judiciary Committee on H. R. 6439* subsequently reported *H. R. 8046*, 75th Cong., 1st Sess. (1937) 10.

revision would destroy the value of court decisions handed down over a long period of time.⁴⁶

Following the rejection of the Hastings-Michener Bill, a nationwide group of men interested in bankruptcy law formed themselves into an organization known as the National Bankruptcy Conference. This body of men did invaluable work in formulating, debating, and refining proposed amendments to the Bankruptcy Act of 1898. Representative Chandler himself attested to this when he said that he "found a very comprehensive draft of a Bill which had been drawn by the National Bankruptcy Conference and I made that draft the basis for the first Bill that was introduced."⁴⁷

The Judiciary Committee of the House of Representatives held extensive hearings on the Bill commencing in April of 1935. Add to this, the hearings held by the Judiciary Committee of the United States Senate and the research and recommendations of the Securities and Exchange Commission, and one is struck with the thoroughness and comprehensiveness of the preparation which preceded the passage of the Chandler Act in June of 1938.

The general purpose the authors of the Chandler Act had in mind was, in the words of Representative Chandler "to modernize and bring up to date the bankruptcy law of our country."⁴⁸ Former United States District Judge George E. Q. Johnson subdivides this purpose in the following manner: "a—clarification; b—improvement of administrative processes; c—granting new privileges to honest but unfortunate debtors; d—minimizing evasions by dishonest debtors; e—perfecting the sections relating to fraudulent conveyances, preferences, and liens; f—improving the partnership section; g—eliminating inconsistent and overlapping provisions of the 'Debtors' Relief' portions of the Act; and h—providing for wage-earners' and real property arrangements."⁴⁹

The Chandler Act

In discussing the Chandler Act we must remember that Congress intended it only as a revision of the Bankruptcy Act of 1898. The latter was not repealed. Thus the court decisions, interpreting the Act of 1898 during the past forty years have not been rendered impotent. They remain quite vital in determining the meaning and value of sections of the old Act that remain the same as they were prior to June 22, 1938.

No attempt will be made in this paper to list and discuss every change in our bankruptcy law occasioned by the Chandler Act. At best we hope to point out and evaluate the more important innovations. Naturally, much attention will be shown to the so-called "Debtor-Relief" sections, for therein lies the very heart and substance of the Chandler Act.

The referees in bankruptcy took on a new position of importance with the

46. H. R. No. 1409, 75th Cong., 1st Sess. (1937) 2.

47. *Hearings before Sub-Committee, Judiciary Committee, Sen. Rep. 75th Cong., 2nd Sess.* (1937) 2.

48. H. R. No. 1409, 75th Cong., 1st Sess. (1937) 3.

49. 8 C. J. S. 17 (Supp.).

advent of the Chandler Act. Re-defining the word "court" so that it shall include not only the district judge but the referee in bankruptcy,⁵⁰ Congress indicated that henceforth new functions would be exercised by the latter. The referee has been given wide jurisdiction, particularly in Chapter XI proceedings. Here he has the power to confirm, refuse to confirm, set aside or modify arrangements.⁵¹ This is also true as regards the similarly constituted Chapter XII⁵² and XIII.⁵³ However, corporate reorganizations under Chapter X are still primarily within the domain of the district judges. Under the straight bankruptcy as distinguished from the "Debtor-Relief" sections of the Act, the referee has received increased authority. His is the power to adjudicate one a bankrupt or to dismiss the petition.⁵⁴ In addition, he may allow, refuse, or revoke discharges.⁵⁵ The referee's acts are always subject to review by the district judges who thus sit in an appellate capacity.

Courts of bankruptcy are now authorized to remove trustees upon their own motion.⁵⁶ Formerly it was necessary for creditors to petition for the removal of trustees. This provision gives the court a strong hand in the bankruptcy proceedings, one that can be used to the advantage of all concerned.

The ancillary jurisdiction of courts of bankruptcy was prior to the Chandler Act in a confused state. Actually nothing is added to the substance of the law involved herein; however, the restatement on this point as contained in the Chandler Act has done much to clarify the situation.⁵⁷

Prior to the enactment of the Amendatory Act much expense and delay was occasioned in bankruptcy proceedings because of the necessity of bringing plenary suits against certain non-bankruptcy trustees, receivers or assignees for the benefit of creditors, who refused to turn over property of the debtor in their possession. Section 2 subdivision 21 not only permits summary proceedings culminating in a turnover order directed against such persons, but also, save in cases involving corporate reorganizations and real property arrangements, permits the court to require an accounting from the person against whom the turnover order was directed, provided possession was obtained within four months prior to the date of bankruptcy.

In reality this section enlarges on rules laid down by the Supreme Court prior to the enactment of the Chandler Act. In 1933 in the case of *Gross v. Irving Trust Co.*,⁵⁸ the court held that, the supervision of bankruptcy proceedings

50. Bankruptcy Act of 1898, § 1, sub. 9, 11 U. S. C. 1.

51. Bankruptcy Act of 1898, § 366, 11 U. S. C. 766; Bankruptcy Act of 1898, § 386, 11 U. S. C. 786.

52. Bankruptcy Act of 1898, § 472, 11 U. S. C. 872; Bankruptcy Act of 1898, § 511, 11 U. S. C. 911.

53. Bankruptcy Act of 1898, § 656, 11 U. S. C. 1056; Bankruptcy Act of 1898, § 671, 11 U. S. C. 1071.

54. Bankruptcy Act of 1898, § 66 sub. 1, 11 U. S. C. 106.

55. Bankruptcy Act of 1898, § 66 sub. 6, 11 U. S. C. 106.

56. Bankruptcy Act of 1898, § 2 sub. 17, 11 U. S. C. 11.

57. Bankruptcy Act of 1898, § 2 sub. 20, 11 U. S. C. 11.

58. 289 U. S. 342 (1933).

within four months of the commencement of a suit in a state court in which receivers had been appointed, deprived the state court of the power to fix the compensation of said receivers. Such power lies in a court of bankruptcy. Again in 1935 the Supreme Court ruled that a state court receiver is not an adverse claimant as to an allowance for services awarded after the filing of a petition in bankruptcy.⁵⁹ Such an allowance is subject to a summary turnover order by the court of bankruptcy.

In amending Section 3a of the Bankruptcy Act of 1898, Congress moved cautiously lest it upset one of the oldest traditions in the law of bankruptcy, namely, that an Act of Bankruptcy must be alleged in every petition seeking an involuntary adjudication of a debtor. One writer in a legal periodical has expressed the idea in the following manner:

"While the act of bankruptcy concept is a vestigial remnant in the body of the law and not only useless but highly obstructive to its modern purposes, its excision at the present time would involve serious complications."⁶⁰

While a few acts of bankruptcy have been reshuffled the only substantial change in Section 3a concerns the addition of equitable insolvency—inability to pay debts as they mature—to legal insolvency as a condition precedent to alleging 3a (5) as an act of bankruptcy.

It is interesting to note that Congress still maintains, as indeed does the Supreme Court by virtue of a five to four decision,⁶¹ that a debtor who has passively "suffered or permitted" certain situations to develop, has been guilty of an act of bankruptcy. Apparently, in bankruptcy law at least, "An Act" has lost its affirmative connotation.

Section 3b has been amended by the Chandler Act so that with respect to the first, second, or fourth acts of bankruptcy, the four months period does not commence to run until after the transfer or assignment has become so far perfected as to exclude the superior rights of bona fide purchasers.

The clarifying purpose of the Act is well illustrated in the last sentence that has been added to Section 4b. Formerly there was much dispute as to whether an individual's status as a farmer or wage-earner should be determined as of the time of the commission of the act of bankruptcy or as of the time the obligation was incurred. Following a district court decision⁶² handed down many years ago, Congress resolved the dispute in favor of the former.

In 1925 the Supreme Court held that a partnership could not be adjudged a bankrupt upon a petition filed against it by one of its members without the consent of the other partners.⁶³ The Chandler Act changes this rule by establishing a hybrid standard—that is a cross between a voluntary and an involuntary petition. Allowing less than all the general partners to file a petition,

59. 293 U. S. 470 (1934).

60. Treiman, *Act of Bankruptcy* (1938) 52 HARV. L. REV. 189, 210.

61. 183 U. S. 191 (1901).

62. 199 Fed. 363 (D. C. Mont. 1912).

63. 268 U. S. 426 (1925).

the Amendatory Act requires an allegation of insolvency but precludes the necessity for an act of bankruptcy.

In an attempt to minimize evasions by dishonest debtors, Congress imposed new duties upon bankrupts. It is now mandatory for a bankrupt to appear at the first meeting of creditors and at such other times as the court shall order. Prior to this first meeting of creditors, bankrupts must furnish a complete statement of financial condition. A most salutary change requires a bankrupt, upon order of the court, to file a detailed inventory showing the cost to him of his assets as of the date of his bankruptcy.⁶⁴

Formerly it was necessary for an adjudicated bankrupt to file, within a prescribed period, an application for his discharge. On occasions, due either to the fault of the bankrupt or his attorney, the time limit would expire and the bankrupt would be barred from obtaining his release. Section 14 of the Bankruptcy Act of 1898, as amended, now provides that "The adjudication of any person, except a corporation, shall operate as an application for a discharge."

It was not an unknown practice in the past for a number of small creditors to band together and block the election of trustees desired by creditors with more substantial claims. In order to prevent such abuses, Congress decreed that all claims of \$50 or less should not be counted in computing the number of creditors, voting or present at creditors meetings, but should be counted in computing the total amount.⁶⁵

The Chandler Act clarifies the definition of a voidable preference by providing that the trustee may avoid any preference received by a creditor, who had reasonable cause to believe that the debtor was insolvent at the time when the transfer was made. Wherever a preference is voidable the trustee may recover the property involved, or if it has been converted, its value, except where a bona fide purchaser has intervened, in which event if said bona fide purchaser has given less than fair value, he shall have a lien upon the property, but only to the extent of the consideration actually given.⁶⁶

A new subsection has been added by the Chandler Act dealing with situations where the bankrupt is a stockholder.⁶⁷ It is particularly noteworthy because it overrules at least two well-known Supreme Court decisions. Back in 1908 the Court ruled that a stockbroker is not the owner of the shares of stock that he purchases and holds for his customers on margin.⁶⁸ But rather he is a mere pledgee. Consequently it is not a preferential transfer for an insolvent stockbroker, in such a position, to turn over to his customer the shares of stock so held. The Court went further and added, "Nor is the right to repledge inconsistent with ownership of the stock in the customer."⁶⁹

Under the rule laid down in *Gorman v. Littlefield*⁷⁰ and *Duel v. Hollins*⁷¹

64. Bankruptcy Act of 1898, § 7, 11 U. S. C. 25.

65. Bankruptcy Act of 1898, § 56c, 11 U. S. C. 92.

66. Bankruptcy Act of 1898, § 60b, 11 U. S. C. 96.

67. Bankruptcy Act of 1898, § 60e, 11 U. S. C. 96.

68. 209 U. S. 365 (1908).

69. 209 U. S. 365, 379 (1908).

70. 229 U. S. 19 (1913).

71. 241 U. S. 523 (1916).

stock of each corporation was to be treated separately when found in the possession of an insolvent stockbroker. However, now according to the terms of Section 60e all securities held by the insolvent broker for his customers are to constitute a single fund, except such as were allocated to or physically set aside for a particular customer prior to insolvency and remained in such condition at the date of bankruptcy.

The authors of the Chandler Act included therein the substance of the Uniform Fraudulent Conveyance Act that has been adopted in many states.⁷² It was a wise move and should prove to be of great value in bringing to justice those dishonest bankrupts who feel, since charity begins at home, that they should leave nothing but the dregs of their unsuccessful enterprises for their creditors.

Indeed the sections intended to remove the dangers of preferential transfers would be of little value if no provision was made to deter fraudulent conveyances. For while a preferential transfer must be made to a creditor, a fraudulent transfer may be made to anyone.⁷³

In the closing hours of the Hoover Administration, Congress amended the Bankruptcy Act of 1898 by adding a chapter entitled, Provisions for the Relief of Debtors.⁷⁴ Since 1910 compositions had been effected under Section 12 of the Bankruptcy Act of 1898, as amended. However, it was first necessary for the debtor to file a bankruptcy petition. A composition might thereafter be granted without a formal adjudication. Under the terms of the amendment of March 3, 1933 the debtor is not required to file a petition in bankruptcy prior to seeking a satisfactory composition agreement. Thus, during the proceedings he continues to be known as the "debtor", never as the "bankrupt." The constitutionality of composition provisions, made binding on non-assenting creditors, has frequently been tested. The courts have repeatedly held them valid.⁷⁵

A popular misconception of a composition makes it synonymous with an extension. The distinction is important and appropriate to consider here, because the remainder of the Chandler Act deals exclusively with the Debtor-Relief provisions. The Circuit Court of Appeals for the Tenth Circuit has defined these terms in succinct fashion as follows:

"A composition by creditors with their debtor in bankruptcy is an agreement between them that the latter will pay down and the former will accept a named per cent of their claims in full satisfaction";⁷⁶

"An extension proposal is an agreement on the part of the creditors that they will extend the time within which their claims are probably to be paid, in full as to secured creditors, on the terms proposed by the debtor and approved by the court."⁷⁷

72. Bankruptcy Act of 1898, § 67d, 11 U. S. C. 107.

73. 6 F. Supp. 58 (S. D. N. Y. 1934).

74. Chap. VIII of Bankruptcy Act of 1898 as amended as it existed prior to Chandler Act.

75. 273 U. S. 380 (1927); 265 U. S. 269 (1924); 237 U. S. 447 (1915); 103 U. S. 217 (1880).

76. 91 F. (2d) 655, 658 (C. C. A. 10th, 1937).

77. *Id.* at 659.

The first of the Debtor-Relief provisions, dealing with Agricultural Compositions and Extensions, will not be the subject of a very detailed analysis in this paper for while it is a part of the Bankruptcy Act of 1898, as amended, it is not a part of the Amendatory Act of June 22, 1938 known as the Chandler Act.

Enacted into law on March 3, 1933, Section 75 of the Bankruptcy Act of 1898, as amended, aimed to save the farmer-debtor from the clutches of creditors who desired to distribute his property. Section 75 is emergency legislation, but its life was extended for another four years by an act of Congress approved on March 4, 1940. It authorizes the farmer to obtain a composition or extension from his creditors. In actual practice this section has proved of little assistance to the hard-pressed farmer for it is necessary that the composition or extension agreement be acceptable to a majority in number and amount of his creditors. Usually the greatest portion of a farmer's total debt consists of the mortgage on his farm, so that the mortgagee is often in a position to bar any agreement.

Aware of the great influence wielded by the mortgagee, Congress in 1934 added sub-section S to section 75. The amendment was commonly known as the Frazier-Lemke Act. The farmer was given the right, after he had failed to obtain a composition or extension, to petition that he be adjudged a bankrupt. The bankrupt farmer was then given the privilege of re-purchasing his farm, at an appraised value, over a period of six years. If the secured creditors should object to this procedure, the farmer was granted a moratorium.

In May of 1935 the Supreme Court held Section 75s (the Frazier-Lemke Act) unconstitutional.⁷⁸ Mr. Justice Brandeis writing for the court pointed out that the bankruptcy power, like the other great substantive powers of Congress is subject to the due process clause of the Fifth Amendment.

"No instance has been found" wrote Mr. Justice Brandeis, "except under the Frazier-Lemke Act, of either a statute or decision compelling the mortgagee to relinquish the property to the mortgagor free of the lien unless the debt was paid in full."⁷⁹

In brief this Act was declared unconstitutional because it deprived secured mortgagees of certain rights in particular property. To be specific, these rights were five in number: 1—the right to insist on full payment before releasing the lien; 2—the right to an auction sale; 3—the right to bid at the sale; 4—the right to select the time for the sale with the consent of the court; 5—the right to control the property during the period of default, subject to the discretion of the court, and to have the rents and profits collected by a receiver for the satisfaction of the debt.

In August of 1935 Congress passed a new Frazier-Lemke Act in which an attempt was made to irradicate the constitutional defects prevalent in the first Act. When this new Act was tested in the Supreme Court, it was held constitutional,⁸⁰ but first it was deemed necessary to construe it in the light of Con-

78. 295 U. S. 555 (1935).

79. 295 U. S. 555, 579 (1935).

80. 300 U. S. 440 (1937).

gressional debates, because "the language of the Act is not free from doubt."⁸¹

Section 77 of the Bankruptcy Act of 1898, as amended, provides for the reorganization of railroads engaged in interstate commerce. Passed in 1933 it was amended in 1935 and 1936. It is not a part of the Chandler Act.

Under the provisions of Section 4 of the Bankruptcy Act railroads are prohibited from being adjudicated bankrupts either voluntarily or involuntarily. However, under Section 77 railroads engaged in interstate commerce, may have their debt structures scaled down while masquerading as "tweedledum" debtor instead of "tweedledee" bankrupt.

The constitutionality of Section 77 was upheld by the Supreme Court in the case of *Continental Illinois National Bank and Trust Co. v. Chicago, Rock Island and Pacific Ry. Co.*,⁸² decided in 1935. In the opinion of the court, Mr. Justice Sutherland sets forth the argument for making reorganization proceedings available to railroads.

"A railway is a unit; it cannot be divided up and disposed of piecemeal like a stock of goods. It must be sold, if sold at all, as a unit and as a going concern. Its activities cannot be halted because its continuous, uninterrupted operation is necessary in the public interest; and for the preservation of that interest as well as for the protection of the various private interests involved, reorganization was evidently regarded as the most feasible solution whenever the corporation had become insolvent or unable to meet its debts as they mature."⁸³

The next debtor-relief provision found in the Bankruptcy Act of 1898, as amended, is Chapter IX, entitled Composition of Indebtedness of Local Taxing Agencies. This Chapter like the preceding sections granting relief to farmers and railroads, is not a part of the Chandler Act. However, passing note must be taken of it so that we may better evaluate the rôle of the following debtor relief sections that are part and parcel of the Chandler Act. Permitting municipalities and taxing districts to consummate debt readjustments, it has been declared constitutional by the Supreme Court,⁸⁴ unlike its predecessor the Municipal Debt Readjustment Act which failed to pass the scrutiny of the Court, because the federal government was allowed to encroach upon the fiscal powers of a sovereign state.⁸⁵ The accent in Chapter IX is upon voluntary agreements between the parties.

Chapter X of the Chandler Act has received such publicity in the public press and in law review periodicals that it has, in the layman's mind, dwarfed into insignificance the remaining sections of this Amendatory Act. It is bankruptcy law arrayed in its most spectacular garments. It creates a legal display of rare appeal.

Corporate reorganizations, as we now know them, are of relatively recent origin, making their first appearance on our statute books in the year 1933. How-

81. 300 U. S. 440, 463 (1937).

82. 294 U. S. 648 (1935).

83. 294 U. S. 648, 671 (1935).

84. 304 U. S. 27 (1938).

85. 298 U. S. 513 (1936).

ever, the reorganization of corporations had been effected for many years prior to this time through the medium of the much abused equity receivership.

A creature, born of necessity, the equity receivership made its debut as an instrumentality of corporate reorganization in the latter part of the nineteenth century. A few newly built railroads of the expansion era soon found themselves in the toils of financial insolvency. Naturally the public interest could not permit their dismemberment, so the federal court resolved the difficulty by resort to an old equitable form. The court would appoint a receiver to take charge of the assets of the debtor and to forestall action on the part of the creditors. A sale of the properties held by the receiver would then be effected to the creditors free of debts. Said properties were then conveyed by the creditors to a new corporation, usually possessing a similar name. Those creditors who acquiesced in the proceedings accepted stock in the new corporation and those who refused were paid partially in cash obtained from the sale of securities to new speculators.

No doubt the equity receivers often proved cumbersome and expensive. It was necessary that ancillary receivers be appointed to hold property of the bankrupt lodged in other jurisdictions. Again the courts of bankruptcy had little authority which could be exercised over the contesting parties. Compensation to be received by committees and their attorneys were not subject to review by the courts.⁸⁶

With the enactment of Section 77 of the Bankruptcy Act, pertaining to the reorganization of railroads, in 1933, Congress for the first time brought reorganization procedure within the scope of the bankruptcy power. In 1934 statutory reorganization was made available to industrial corporations with the advent of the well-known Section 77B.

Some of the changes wrought by Section 77B are worth noting here. Of primary importance was the provision granting one court jurisdiction. Ancillary receiverships were thereby rendered useless. Two-thirds of the creditors could bind a dissenting minority by agreeing to a fair and equitable plan. No longer was it necessary to pay off in cash obdurate creditors. Another provision of 77B, and this is of debatable value, allowed the debtor to remain in control of his business.

Chapter X is more than an amendment to Section 77B. It supersedes it. Consequently a thorough discussion of Chapter X is in order.

Any corporation save: a—municipal, insurance or banking corporations or a building and loan association; and b—a railroad corporation that may obtain relief under Section 77, may avail itself of Chapter X.⁸⁷ First, however, the corporation must set forth facts in its petition indicating why it cannot obtain adequate relief under Chapter XI pertaining to "Arrangements."⁸⁸ A dissolved corporation may not initiate reorganization proceedings since it has ceased to exist.⁸⁹ However, it would seem that the creditors of a dissolved corporation

86. 282 U. S. 311 (1931).

87. Bankruptcy Act of 1898, § 106 (3), 11 U. S. C. 506.

88. Bankruptcy Act of 1898, § 130 (7), 11 U. S. C. 530.

89. 302 U. S. 120 (1937).

may petition for reorganization.⁹⁰ Incidentally, the cases determining the last two points were decided under Section 77B, but since Chapter X has made no affirmative change, they serve to indicate that all former judicial opinions have not been rendered valueless.

Reorganization proceedings may be of a voluntary or involuntary nature. If involuntary the petition must be signed by three or more creditors whose claims aggregate at least \$5,000. Said claims must be liquidated as to amount and not contingent as to liability.⁹¹

Upon the approval of a petition the district court has all the jurisdiction, powers, and duties possessed by a bankruptcy court after adjudication or of an equity court upon the appointment of an equity receiver.⁹²

"If no bankruptcy proceeding is pending, an original petition may be filed with the court in whose territorial jurisdiction the corporation has had its principal place of business or its principal assets for the preceding six months or for a longer portion of the preceding six months than in any other jurisdiction."⁹³

However, if the interests of the parties will best be served, the court may transfer the proceedings to another district, as was done in the case of the Associated Gas and Electric Company whose reorganization is now pending in the District Court for the Southern District of New York.⁹⁴

If a petition has been filed in "good faith", the Judge must approve it. If not, he must disapprove it.⁹⁵ A petition will be deemed to have been filed not in "good faith" if (1) the petitioning creditors have acquired their claims for the purpose of filing the petition; (2) adequate relief would be obtainable by a debtor's petition under the provisions of Chapter XI of the Act; (3) it is unreasonable to expect that a plan of reorganization can be effected; or (4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.⁹⁶ The petitioner has the burden of establishing good faith.⁹⁷ Since the above mentioned instances evidencing bad faith in no way limit the generality of the meaning of the term "good faith",⁹⁸ it is primarily a question of fact to be decided by the Bankruptcy Court.⁹⁹

Chairman of the Securities and Exchange Commission (now Mr. Justice) William O. Douglas has said that,

90. 76 F. (2d) 834 (C. C. A. 2d, 1935).

91. Bankruptcy Act of 1898, § 126, 11 U. S. C. 526.

92. Bankruptcy Act of 1898, § 114, 11 U. S. C. 514; Bankruptcy Act of 1898, § 115, 11 U. S. C. 515.

93. Bankruptcy Act of 1898, § 128, 11 U. S. C. 528.

94. Bankruptcy Act of 1898, § 118, 11 U. S. C. 518.

95. Bankruptcy Act of 1898, § 141, 11 U. S. C. 541.

96. Bankruptcy Act of 1898, § 146, 11 U. S. C. 546.

97. 75 F. (2d) 284, 285 (C. C. A. 2d, 1935).

98. Bankruptcy Act of 1898, § 146, 11 U. S. C. 546.

99. 90 F. (2d) 665 (C. C. A. 8th, 1937); 81 F. (2d) 981 (C. C. A. 7th, 1936).

"the independent trustee is the key to real reform. In comparison, the other reforms are secondary."¹⁰⁰

Chapter X makes the appointment of such a trustee mandatory in all cases where the liabilities total \$250,000 or more.¹⁰¹ This is a major change wrought by Chapter X. Under 77B it was possible to continue the debtor in possession. This it was believed would eliminate an item of great expense and at the same time interfere as little as possible with the smooth running of the debtor's business. The Securities and Exchange Commission made the disinterested trustee the crux of its program and Congress bowed to its wishes. In addition to the disinterested trustee, the court may appoint a director, officer or employee as a co-trustee. His duties, however, are confined to the operation of the business.¹⁰² Another unique, though not startling requirement is that the trustee be competent to perform his duties. Before final confirmation the trustee must weather a statutory hearing where objections to his availability may be pressed by any interested parties.¹⁰³

The trustee is required, at the direction of the judge, to investigate the debtor's acts, conduct, property, and financial condition, and to explore the feasibility of continuing the business. He must report to the judge all facts pertaining to fraud, misconduct, mismanagement or other forms of irregularity, and any causes of action open to the estate. He may, if the judge directs, examine any director or officer of the debtor or any other witness having knowledge concerning the subject matter of the investigation.¹⁰⁴

One of the most important duties imposed upon a trustee concerns the role he must play in formulating a plan of reorganization. First he must give notice to creditors and stockholders so that they may submit to him suggestions relative to the plan.¹⁰⁵ Thus the trustee's office becomes a sort of clearing house for ideas. The trustee must then prepare a plan or report to the judge his reasons why a plan cannot be effected.¹⁰⁶ The importance of the trustee in the initiation of a plan is original with the Chandler Act. Under both equity receiverships and 77B the formulation of the plan fell into the hands of those whose prime interest was salvaging something for themselves. It is the expectation of Congress and the Securities and Exchange Commission that the "disinterested" trustee will perform this task in a disinterested manner.

Commissioner Eicker of the Securities and Exchange Commission has said that,

"We regard the objectivity of the trustee, and incidentally of his attorney, who must

100. *Hearing before Committee on the Judiciary H. R. 6439 subsequently reported, H. R. 8046, 75th Cong., 1st Sess. (1937)* 177.

101. Bankruptcy Act of 1898, § 156, 11 U. S. C. 556.

102. Bankruptcy Act of 1898, § 156, 11 U. S. C. 556; Bankruptcy Act of 1898, § 189, 11 U. S. C. 589.

103. Bankruptcy Act of 1898, § 162, 11 U. S. C. 562.

104. Bankruptcy Act of 1898, § 167, 11 U. S. C. 567.

105. Bankruptcy Act of 1898, § 167 (6), 11 U. S. C. 567.

106. Bankruptcy Act of 1898, § 169, 11 U. S. C. 569.

likewise measure up to similar standards of disinterestedness, as so vital to the proper functioning of the Chandler Act that we have been jealous of any attempt to undermine the prescribed standards."¹⁰⁷

Chapter X allots the Securities and Exchange Commission a two-fold function. First, active participation in reorganization proceedings and secondly, the rendition of advisory reports. In addition to cases where it is able to file an appearance, the Securities and Exchange Commission must, in cases involving more than \$3,000,000, and may in cases involving less, be given an opportunity to examine and report on the plan of reorganization.¹⁰⁸

As a practical matter the ratio of appearances in Chapter X proceedings is about one out of eleven.¹⁰⁹ The Securities and Exchange Commission does not make a practice of interfering in the reorganization of small or closely held corporations, for these are rarely affected with a public interest. Mr. J. Anthony Panuch, Special Counsel to the Reorganization Division of the Securities and Exchange Commission has replied to the question as to what constitutes sufficient public interest as follows:

"Since each reorganization is in many respects *sui generis*, no hard and fast answer is possible. As you know, the Commission's primary concern is the protection of the public investor interest and, while each case necessarily depends on its own specific considerations the Commission has adopted a sort of *prima facie* rule that, absent exceptional circumstances, participation will not be sought in cases where the face amount of the debtor's publicly held securities is less than a quarter of a million dollars."¹¹⁰

All recommendations of the Securities and Exchange Commission are of an advisory nature. They are not binding on the courts. This should have a very salutary effect upon all concerned.

The plan of reorganization is the ultimate goal of Chapter X. We have seen the role played by the trustee in the promulgation of the plan and have noted that in addition to being approved by the judge the plan must be accepted by a certain percentage of all interested parties. The requisite percentage is fixed at two-thirds in amount of the claims filed and allowed of each class of creditors and in case the debtor has been found not to be insolvent, a majority of the stockholders.¹¹¹ No good purpose will be served in recounting here the various provisions that must or may be found in every plan of reorganization. They are all set forth in Section 216 of the Act. However, of primary importance is the injunction that no plan may be confirmed by the judge unless it is "fair, equitable and feasible."¹¹²

107. Address of Edward C. Eicher before Annual Convention of American Bar Association—July 11, 1939.

108. Bankruptcy Act of 1898, § 172, 11 U. S. C. 572.

109. Address of E. C. Eicher before Annual Convention of American Bar Association—July 11, 1939.

110. Address of J. A. Panuch before New York County Lawyers Association—November 21, 1939.

111. Bankruptcy Act of 1898, § 179, 11 U. S. C. 579.

112. Bankruptcy Act of 1898, § 221 (2), 11 U. S. C. 621.

On the face of it, this precept would seem to indicate that its interpretation lay within the sound discretion of the individual judge. But such is not the case. The fact that all but a small percentage of the security holders have approved the plan is not the test that determines whether a plan is a fair and equitable one.¹¹³ Indeed a court is required to consider the fairness of the plan even though no objections have been expressed.¹¹⁴ One court has held that a plan is fair and feasible if "it is economically expedient, without discrimination or destruction of vested rights."¹¹⁵

Under the equity receivership form of reorganization stockholders of the old corporation frequently secured choice positions in the new, while creditors of the former received scant attention in the latter. Then in 1913 the Supreme Court, in the famous case of *Northern Pac. Ry. Co. v. Boyd*,¹¹⁶ enunciated with finality what has come to be known as the "strict priority rule." Briefly stated, Boyd was an unsecured creditor of the old corporation. Under the plan of reorganization the old stockholders, upon advancing some money, were given a participation in the new corporation while the unsecured creditors were passed over. The Court allowed Boyd to follow the property of the new corporation, which had been acquired from the old, and seek his remedy against it. In other words as far as Boyd was concerned the Court treated the sale under the reorganization plan as a fraudulent conveyance and set it aside.

Apparently the legal profession had difficulty in determining the implications of the *Boyd* case.¹¹⁷ As if to reiterate its position with greater force the Supreme Court in November of 1939 in *Case v. Los Angeles Lumber Products Co. Ltd.*¹¹⁸ held that creditors are entitled to absolute priority over stockholders against all the property of an insolvent corporation. The one exception which permits stockholders to fare better than creditors under a plan of reorganization concerns a situation where said stockholders advance new money or money's worth and then their participation must be based solely on this contribution and must be reasonably equivalent to it.¹¹⁹ A finding that certain stockholders have "financial standing and influence in the community" and can furnish a "continuity of management" is not sufficient basis for extending them priority over creditors in the plan of reorganization. The Supreme Court ruled that,

"such items are illustrative of a host of intangibles which, if recognized as adequate consideration for issuance of stock to valueless junior interests, would serve as easy evasions of the principle of full and absolute priority of *Northern Pacific Railway Co. v. Boyd*, *supra*, and related cases."¹²⁰

Moreover, such items,

113. 308 U. S. 106 (1939).

114. 22 F. Supp. 664 (E. D. Pa. 1938).

115. *Ibid.*

116. 228 U. S. 482 (1912).

117. (1939) 48 YALE L. J. 1334, 1346.

118. 308 U. S. 106 (1939).

119. *Id.* at 121.

120. *Id.* at 122.

"have no place in the asset column of the balance sheet of the new company. They reflect merely vague hopes or possibilities."¹²¹

Another finding that if the bondholders were to foreclose instead of allowing the reorganization to be consummated they would receive "substantially less than the present appraised value" of the corporation's assets, was held to be insufficient grounds for extending priority to the stockholders over creditors. "The fact that bondholders might fare worse as a result of a foreclosure, and liquidation than they would by taking a debtor's plan under Section 77B can have no relevant bearing on whether a proposed plan is 'fair and equitable' under that section. Submission to coercion is not the application of 'fair and equitable' standards."¹²²

In order to adhere to the "strict priority" rule it is not necessary that creditors be paid in cash as a condition precedent to the retention by the stockholders of an interest in the reorganized corporation. "His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock."¹²³

Unwarranted preference for stockholders over creditors in a plan of reorganization is not the only method of violating the "strict priority" rule. It is just as offensive to prefer a junior class of creditors to a class senior in rank.

In passing on the plan of reorganization the judge should be ever mindful that "the bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment."¹²⁴ Consequently any plan that deprives a secured creditor of full compensation where the security is ample violates the Fifth Amendment.¹²⁵

It would seem that the secured creditor has every reason to be grateful for the reiteration of the "strict priority" rule in the *Los Angeles Lumber* case. For apparently it not only preserves for him the full protection of his security, if he should demand it, but at the same time it overcomes the greatest constitutional defect in the Bankruptcy Act as it now reads. Section 77E, dealing with Railroad Reorganizations permits the judge to confirm the plan of reorganization, despite the fact that it has not been accepted by the requisite percentage of creditors and stockholders, if he is satisfied that it makes "fair and equitable" provision for those rejecting it. Conceivably a judge may decide that in a particular case it is "fair and equitable" for a certain class of secured creditors to take less than their security guarantees them. Under the provisions of Section 77E the judge could then confirm the plan, regardless of the fact that his action would be violative of the Fifth Amendment, in that it deprives individuals of their property without due process of law.

Under the provisions of Chapter X, while it is true that the judge cannot confirm the plan without the approval of two-thirds of the creditors of each class of securities, yet the germ of unconstitutionality is present. Taking a

121. *Ibid.*

122. 308 U. S. 106, 123 (1939).

123. 228 U. S. 482, 508 (1912).

124. 295 U. S. 555, 589 (1935).

125. 90 F. (2d) 992 (C. C. A. 9th, 1937).

hypothetical case, suppose two-thirds of the secured creditors agreed to take less than the full amount of their security. What would be the position of the remaining secured creditors who dissent? The Bankruptcy Act itself seems to indicate that if the judge deemed the plan "fair and equitable", they would have to submit. Certainly this too would be violative of the Fifth Amendment when viewed in the light of *Louisville Joint Stock Land Bank v. Radford* (the first Frazier-Lemke Act case).

Congress evidently deemed the "fair and equitable" requirements of the plan sufficient protection for individual creditors. In fact, it has turned out to be an ample cloak of security, but only because the Supreme Court in the *Los Angeles Lumber* case reënforced the "strict priority" doctrine by holding it to be an essential part of any fair and equitable plan. If a different theory had been sponsored by the Court there can be little doubt but that the above mentioned provisions of the Bankruptcy Act would have clashed with the Fifth Amendment.

When a plan of reorganization cannot be consummated, the judge shall either dismiss the proceeding or adjudge the debtor a bankrupt.¹²⁶

Authority to make allowances for services rendered in the reorganization lies exclusively with the court. It is possible for individuals, be they creditors or stockholders, to be compensated, provided the services rendered contributed to the affirmance or disaffirmance of the plan, or were of value in the administration of the estate.¹²⁷ Plainly the purpose intended by Congress was the encouragement of participation by individuals in the creation of the plan.

Appeals taken in reorganization proceedings are regulated, just as they were under 77B, by the rules applicable in straight bankruptcy proceedings.¹²⁸ They have, however, undergone a thorough revision.

It has been the practice of the court, at least under 77B and there is no reason to believe Chapter X has brought about a change, to allow appeals only to those who might be classified as parties to the litigation.¹²⁹ Creditors and bondholders must be permitted to formally intervene before they may avail themselves of the right to appeal.¹³⁰ A stockholder may only appeal as of right, without permission to intervene, in questions involving the permanent appointment of trustees or the proposed confirmation of a plan of reorganization.¹³¹

Under 77B the law was in an unsettled state as to whether or not leave to appeal must be obtained from the appellate court.¹³² The reason assigned for the difficulty was the necessity of following a rather nebulous distinction between "proceedings" in bankruptcy and "controversies" arising out of bankruptcy proceedings. The former evidently applied to matters of administration, while the latter covered disputes occurring between the trustee and third parties who

126. Bankruptcy Act of 1898, § 236 (1) and (2), 11 U. S. C. 636.

127. Bankruptcy Act of 1898, § 243, 11 U. S. C. 643.

128. Bankruptcy Act of 1898, § 121, 11 U. S. C. 521.

129. 82 F. (2d) 481 (C. C. A. 3rd, 1935).

130. 79 F. (2d) 478 (C. C. A. 7th, 1935).

131. 83 F. (2d) 391 (C. C. A. 7th, 1936).

132. 10 REMINGTON, BANKRUPTCY (1939) 570.

were not within the jurisdiction of the bankruptcy court. Under 77B, in a "proceeding" in bankruptcy, an appeal could only be taken by leave of the appellate court, unless the sum involved exceeded \$500. The Chandler Act has eradicated the distinction mentioned above, that existed under 77B, with one exception. Now it is provided "That when any order, decree, or judgment involves less than \$500, an appeal therefrom may be taken only upon allowance of the appellate court."¹³³ The one exception concerns interlocutory orders. Where they are the subject of appeal the old distinction, between "proceedings" in bankruptcy and "controversies" arising out of bankruptcy proceedings, is pertinent.¹³⁴ It should be noted, however, that the statute is none too clear on this point. The language will bear interpretation.

Upon the consummation of a plan of reorganization, the judge must enter a final decree; (1) discharging the debtor from all its debts and liabilities and terminating all rights and interests of stockholders of the debtor, except as provided in the plan or in the order directing or authorizing the transfer of the retention of property; (2) discharging the trustee, if any; (3) making such provisions by way of injunction or otherwise as may be equitable; and (4) closing the estate.¹³⁵

Chapter XI of the Chandler Act deals with the subject of "Arrangements." Congress defines an "arrangement" as "any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms."¹³⁶ Chapter XI evolved from a union of the old Sections 12 and 74. Many new features have been added.¹³⁷

Only voluntary petitions under this chapter are permitted.¹³⁸ The reason for denying other than the debtor the right to seek an arrangement lies in the fact that it was enacted for the benefit of debtors and not creditors. The answer to the pertinent question as to who may be classified as a debtor is found in Section 306 (3) where a debtor is defined as "a person who could become a bankrupt under section 4 of this Act and who files a petition under this chapter." Of course, the petition must state that the debtor is either insolvent or unable to pay his debts as they mature.¹³⁹ In addition the petition must set forth the provisions of the arrangement proposed by the debtor.¹⁴⁰ It is permissible for a debtor to file a petition for arrangement either before or after his adjudication in a pending bankruptcy proceeding¹⁴¹ or he may file his petition despite the fact that no bankruptcy proceeding has been initiated.¹⁴² The Act gives the court before whom the petition is filed exclusive jurisdiction over both the debtor

133. Bankruptcy Act of 1898, § 24a, 11 U. S. C. 47.

134. *Ibid.*

135. Bankruptcy Act of 1898, § 227, 11 U. S. C. 627.

136. Bankruptcy Act of 1898, § 306 (1), 11 U. S. C. 706.

137. H. R. REP. No. 1409, 75th Cong., 1st Sess. (1937) 50.

138. Bankruptcy Act of 1898, § 321, 11 U. S. C. 721.

139. Bankruptcy Act of 1898, § 323, 11 U. S. C. 723.

140. *Ibid.*

141. Bankruptcy Act of 1898, § 321, 11 U. S. C. 721.

142. Bankruptcy Act of 1898, § 322, 11 U. S. C. 722.

and his property, wherever located.¹⁴³ After the petition has been filed the court has authority, (1) to permit rejection of the executory contracts of the debtor upon notice to interested parties; and (2) to permit the receiver, trustee, or debtor in possession to lease or sell any of the debtor's property, whether real or personal.¹⁴⁴

The district judge may refer a Chapter XI proceeding entirely to a referee,¹⁴⁵ who thus may play a role he is barred from assuming under Chapter X where his usefulness is limited. If the court should deem it necessary, it may appoint, upon the application of a party in interest, a receiver, or continue in office a trustee already qualified in a bankruptcy proceeding.¹⁴⁶

The court must, as soon as expedient, call a meeting of creditors, upon ten days' notice to the interested parties.¹⁴⁷ At this meeting the judge or referee must preside. He may receive proofs of claim and allow or disallow them. He must examine the debtor or cause him to be examined and hear witnesses on any matter relevant to the proceeding. He must also receive and determine the written acceptances of creditors on the proposed arrangement. Said acceptances may be secured by the debtor prior to the filing of the petition.¹⁴⁸

The Court may divide the creditors into classes and, if a controversy arise, summarily determine it after a hearing on notice.¹⁴⁹

Generally speaking an arrangement must include provisions modifying or altering the rights of unsecured creditors, either as a group, or some class of them, upon any terms or for any consideration.¹⁵⁰ Section 357 sets forth more specifically what provisions may be included.

Before an arrangement can be confirmed by the court it must have been accepted by a majority in number of all the creditors, or if the creditors have been divided into classes, a majority of each class.¹⁵¹

The court must confirm the arrangement if it is satisfied that, (1) the provisions of Chapter XI have been complied with; (2) the arrangement is to the best interests of the creditors; (3) it is fair and equitable and feasible; (4) the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; and (5) the proposal and its acceptance are in good faith and have not been made or procured by any means, promises, or acts forbidden by the Act.¹⁵²

No petition for an arrangement can be confirmed if the debtor has been granted a discharge in bankruptcy within six years or has had an arrangement by

143. Bankruptcy Act of 1898, § 311, 11 U. S. C. 711.

144. Bankruptcy Act of 1898, § 313, 11 U. S. C. 713.

145. Bankruptcy Act of 1898, § 331, 11 U. S. C. 731.

146. Bankruptcy Act of 1898, § 332, 11 U. S. C. 732.

147. Bankruptcy Act of 1898, § 334, 11 U. S. C. 734.

148. Bankruptcy Act of 1898, § 336, 11 U. S. C. 736.

149. Bankruptcy Act of 1898, § 351, 11 U. S. C. 751.

150. Bankruptcy Act of 1898, § 356, 11 U. S. C. 756.

151. Bankruptcy Act of 1898, § 362, 11 U. S. C. 762.

152. Bankruptcy Act of 1898, § 366, 11 U. S. C. 766.

way of composition during the same period.¹⁵³

The provisions listed above are, I believe, the highlights of Chapter XI, excluding such provisions as are repetitious of what was discussed under Chapter X. Far from partaking of the intricate nature of Chapter X, Chapter XI is, just what it was meant to be, a quick, inexpensive method of composition for debtors who have outstanding unsecured obligations.

There can be little doubt but that it was the intention of the authors of Chapter XI (and it is chiefly the brain-child of the National Association of Credit Men) that it would be used only by small corporations.¹⁵⁴ Yet there is nothing in the Chapter which excludes debtors from availing themselves of it because of their size. Naturally the management of a debtor would prefer to come into a court of bankruptcy under Chapter XI instead of under Chapter X. Under the former chapter the debtor can avoid the mandatory appointment of a trustee in cases where its assets exceed \$250,000. The debtor in control is the rule rather than the exception under Chapter XI. It is the debtor who propounds the plan of arrangement and the creditors sole function is the acceptance or rejection of said plan.¹⁵⁵ Again the Securities and Exchange Commission does not play as important a role in an arrangement as it does in the case of a corporate reorganization. It may not on its own make an investigation for the benefit of the court. Still another important advantage of Chapter XI from the viewpoint of the debtor is the fact that he may secure acceptances of his proposed arrangement from a majority of his creditors prior to approval of the plan by the court. This constitutes a pre-judging of the fairness of the arrangement by a majority of those who stand to gain or lose most by its consummation. While a court may still refuse to confirm the plan this prior acceptance constitutes pressure that is not desirable.

The outstanding example of a large corporation with widely held securities attempting to avail itself of Chapter XI, is the case of *In re United States Realty and Improvement Company*.¹⁵⁶ The district court and the circuit court of appeals believed the company to be within its legal rights when it sought an arrangement with respect to its unsecured obligations. The United States Supreme Court¹⁵⁷ in a five to three decision reversed the lower courts and held that Chapter XI was not a proper vehicle of judicial relief for a company of the size of the U. S. Realty.

Mr. Justice Roberts, in his dissenting opinion, points out that the S. E. C.'s argument against the use of Chapter XI by the U. S. Realty is based on a contention that

153. Bankruptcy Act of 1898, § 371, 11 U. S. C. 771; Bankruptcy Act of 1898, § 14c (5), 11 U. S. C. 32.

154. *Hearings before Committee on the Judiciary, H. R.* 6439 subsequently reported, *H. R.* 8046, 75th Cong., 1st Sess. (1937) 36.

155. Bankruptcy Act of 1898, § 306 (1), 11 U. S. C. 706; Bankruptcy Act of 1898, § 323, 11 U. S. C. 723; Bankruptcy Act of 1898, § 357, 11 U. S. C. 757.

156. 108 F. (2d) 794 (C. C. A. 2nd, 1940).

157. 310 U. S. 434 (1940).

"Congress intended the more detailed and cumbersome procedure of Chapter X to apply wherever securities of the corporation were held by the public, whereas Chapter XI was intended to apply only in the case of individuals or corporations not having such securities outstanding."

The Justice goes on to say that,

"The Act will be searched in vain for any hint of such a distinction."

The language of Chapter XI is very clear. The words used are not ambiguous. Nor indeed did Mr. Justice Stone, writing the majority opinion attempt to base his opinion on any such ambiguity. He held that,

"the case stated most favorably to respondent is that it has prepared an arrangement which appears on its face not to be 'fair and equitable' and hence not to be entitled to confirmation under Chapter XI."

This would all be very well if the court had been reviewing a determination of the district court that the plan of arrangement was "fair and equitable." But this was not the situation. The Supreme Court was reviewing a determination by the district court that the petition under Chapter XI had been properly filed. The district court never reached a point in its control of the proceedings where it ruled on the merits of the plan. The distinction is clear and important. For all that is necessary for the filing of a petition to be approved, is that the petitioner has rigidly adhered to the literal requirements of Chapter XI. This it concededly did. The plan could have been amended later. The equities of the situation are determined subsequent to the filing of the petition. Few can deny that the conclusion reached by the Supreme Court in the *U. S. Realty* case was desirable. Clearly Chapter X is more acceptable than Chapter XI as a vehicle for the readjustment of a large corporation's financial burden. But there are many who do differ with the majority of the court because they question the propriety of the court's enacting a little judicial legislation.

Since the effect of the Supreme Court decision in the *U. S. Realty* case is to deny a party relief under Chapter XI, when any reasonable review of the Chapter will clearly indicate that the respondent has followed the "letter of the law", it is not going too far afield to point out that the Supreme Court has repeatedly held that where the language of a statute is unambiguous any judicial construction which adds to or subtracts from what is written, is not permitted. In *Oscha v. United States*, 300 U. S. 98, 101, the Court wrote,

"and in penal statutes, as in those of a different character, 'if the language be clear, it is conclusive.'"

Again, in *Palmer v. Massachusetts*, 308 U. S. 79, 83, Mr. Justice Frankfurter, in more august language, expresses a similar view. The following, from Mr. Justice Brandeis' opinion in *Iselin v. United States*, 270 U. S. 245, 250, 251, and again quoted by him in *Wallace v. Cutten*, 298 U. S. 229, 237, is particularly appropriate in a discussion as to whether or not Chapter XI was the proper statutory vehicle for the U. S. Realty Company:

"The statute was evidently drawn with care. Its language is plain and unambiguous.

What the government asks is not a construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably (possibly) by inadvertence may be included within its scope. To supply omissions transcends the judicial function."

Whether or not it would be well to permit our courts to enlarge upon legislation when they deem it advisable is a question outside the ken of this paper.

Chapter XII, entitled Real Property Arrangements by Persons other than Corporation, was enacted for the purpose of aiding "the 'little fellow' who is neither a farmer, nor a railroad, nor a business corporation, nor a taxing agency."¹⁵⁸

Congress believed that it was in the interest of the simplification of the "judicial machinery" to place arrangements affecting unsecured debts and debts secured by real property or chattels real in different chapters of the Bankruptcy Act.¹⁵⁹ As under the other "Debtor-Relief" sections of the Chandler Act no adjudication as a bankrupt is necessary before one may seek relief under this chapter. Thus the so-called stigma of bankruptcy is obviated.

Chapter XIII is concerned with the relief of wage-earners. Indeed wage-earners seem to be the special favorites of Congressmen when they set about passing bankruptcy legislation. Under Section 4a of the Act a wage-earner is permitted to file a voluntary petition regardless of his financial position. However, under 4B of the Act an involuntary petition may not be filed against him unless his earnings exceed \$1,500 a year. Despite this Congressional interest in his welfare it seems that as a practical matter adequate relief had heretofore been denied him. For example, under old Section 12, which allowed compositions, a court of bankruptcy could not retain jurisdiction subsequent to the confirmation of a composition. A wage-earner is rarely in a position to make any settlement that is not predicated on future earnings. So at the very time when the composition agreement was of some substantive value to creditors, the court lacked jurisdiction. With the advent of Section 74 in 1933 it was thought that a wage-earner could obtain relief under it. But again as a practical matter such was not the case. For Section 74 required that the debtor deposit in advance in cash the cost of the proceedings, and for those whose sole chance of meeting obligations lay in the future it was a valueless remedy.

It is interesting to note that while Chapter XIII allows unsecured creditors to be dealt with as a class, secured creditors must be dealt with individually.¹⁶⁰ This distinction it is pointed out by the House Committee on the Judiciary "is made necessary by the decision of *Louisville Joint Stock Land Bank v. Radford*."¹⁶¹ In this case,¹⁶² it will be recalled, the United States Supreme Court invalidated the first A. A. on the ground that it violated the Fifth Amendment

158. 7 REMINGTON, BANKRUPTCY (1939) 311.

159. *Hearings before House Committee on the Judiciary*, H. R. 6439 subsequently reported H. R. 8046, 75th Cong., 1st Sess. (1937) 51.

160. Bankruptcy Act of 1898, § 652 (1), 11 U. S. C. 1052.

161. HOUSE HEARINGS, *op. cit. supra* note 159, at 54.

162. 295 U. S. 55 (1934).

in that it deprived creditors of rights in specific property acquired prior to the passage of the law.

It is now necessary that every wage-earner plan of arrangement contain a provision that the debtor will cause his future earnings to come under the supervision and control of the court.¹⁶³ This overcomes one of the disadvantages of old Section 12.

The fourteenth chapter of the Bankruptcy Act dealing with "Maritime Commission Liens" is the work of the Maritime Commission. Its purpose is to assure the continued operation of this nation's ships in foreign commerce.

In brief it permits a court of bankruptcy, equity or admiralty to designate the Commission as sole trustee, with its consent, for any corporation operating vessels of United States registry in foreign commerce, upon which the United States holds mortgages, if it believes that it will inure to the benefit of the estate and other parties in interest and that it will tend to further the purpose of the Merchant Marine Act of 1936. In such proceedings the appointment of any person other than the Commission does not become final until ratified by said Commission.¹⁶⁴

The next section gives the Court authority to allow the Commission to operate such vessels in foreign commerce where the court is unwilling to permit the trustee or receiver to so operate them pending the termination of the proceedings. First, however, the Commission must certify that the continued operation of the vessels is necessary.¹⁶⁵

The final section of Chapter XIV merely provides that no injunctive powers vested in courts of bankruptcy apply to the United States as a creditor under a preferred ship mortgage unless the Commission waives in writing the provisions of this section.¹⁶⁶

Chapter XV, the most recent major addition to the Bankruptcy Act of 1898, deals with "Railroad Adjustments." Strictly speaking it is not a part of the Chandler Act, having been enacted into law subsequent to June 22, 1938.

In brief, any railroad corporation which has not been the subject of an equity receivership or been in process of reorganization under Section 77 of the Bankruptcy Act during the ten years prior to the filing of its petition, is entitled to file said petition, providing certain conditions have been met. These conditions include a requirement that the Interstate Commerce Commission issue an order authorizing the financing contained in the proposed plan of adjustment, based upon certain findings of fact which must be included in said order. It is also necessary that the railroad secure assents to the plan of adjustment by creditors representing more than two-thirds of the aggregate amount of all the claims affected by the plan. The two-thirds must include at least a majority of the total amount of claims in each affected class. In addition the railroad must set forth in its petition a statement to the effect that it is unable to meet its

163. Bankruptcy Act of 1898, § 646 (4), 11 U. S. C. 1046.

164. Bankruptcy Act of 1898, § 701, 11 U. S. C. 1101.

165. Bankruptcy Act of 1898, § 702, 11 U. S. C. 1102.

166. Bankruptcy Act of 1898, § 703, 11 U. S. C. 1103.

debts, matured or about to mature, and that it desires to carry out the plan of adjustment. Further "it must appear that the railroad corporation's inability to meet its debts matured or about to mature is reasonably expected to be temporary only."¹⁶⁷

It is interesting to note that all proceedings under Chapter XV must be conducted before a special three-judge court convened for that purpose. An appeal from any final order or decree of this court is taken direct to the United States Supreme Court.

The jurisdiction conferred by Chapter XV terminates on July 31, 1940, except in respect of any proceeding initiated by filing a petition prior to that date.

Evaluation of the Chandler Act—Changes That Have Been Recommended

I do not believe that one can adequately appraise the Chandler Act by just picking up the finished product and reading it. The proper perspective, it seems to me, is obtained by viewing it as a piece of legislation that has evolved from centuries of experience in bankruptcy law both in this country and abroad. It is for this reason that I prefaced my discussion of the Act itself with an historical résumé calculated to indicate the origin and purposes of various concepts that have now become fixed in our bankruptcy jurisprudence.

A period of little more than two years is hardly sufficient in which to pass final judgment on the real value of the Chandler Act. It is not the type of legislation that meets instantaneously with either popular approval or disapproval. Many of its most important features have yet to be "tried by fire." Particularly is this so with regard to Chapter X, dealing with corporate reorganization.

The Fifth Annual Report of the Securities and Exchange Commission transmitted to Congress on January 3, 1940 sets forth certain statistics with regard to corporate reorganizations for the period running from June 22, 1938 until June 30, 1939. It shows for example that during said period 577 companies, with total assets of approximately \$527,000,000, availed themselves of Chapter X.¹⁶⁸ Such figures I do not consider particularly significant, for the real value of remedial legislation cannot be judged by the number of "patients" it secures, but rather by the number of "cures" it effects. The period of "convalescence", required for the average corporation undergoing a reorganization, is, unfortunately, of long duration.

If one were to say that the Chandler Act represents a substantial improvement over prior bankruptcy legislation, I do not believe he would be guilty of mere speculation. Those who formulated the amendatory act did so fully conscious of defects plainly apparent in the then existing law. They set about their task of streamlining the Bankruptcy Act of 1898 with the avowed purpose of overcoming said defects. The remedies they suggested were not haphazardly conceived but represented the fruits of earnest and learned endeavor. Only the inexperienced or the fool would contend that the Chandler Act is the perfect

167. *Lehigh Valley Railroad Company, et al.*, D. C. E. D. Pa., No. 21011.

168. 5TH ANNUAL REPORT OF THE SECURITIES AND EXCHANGE COMMISSION (1939) 266.

form of bankruptcy law. Already many suggestions have been advanced to further refine it and make it a better instrument of justice. Whether or not they in turn will withstand the scrutiny of a discerning bar remains to be seen.

The following are just a few of the proposed changes in the Chandler Act that have received consideration. Most of them have been incorporated in bills advanced either in the Senate or in the House of Representatives. Where or how they originated is not really important. Their substance is what should interest those concerned with the future of bankruptcy legislation.

(1) Should a general assignment for the benefit of creditors constitute an act of bankruptcy? It has been suggested that it should bear weight only when joined with another act of bankruptcy.

To answer the question first, it would appear that it is sound judgment to include a general assignment for the benefit of creditors within the acts of bankruptcy. It is a necessary compliment to those provisions that make fraudulent conveyances and preferences also acts of bankruptcy. A general assignment is simply an attempt on the part of a debtor to place his assets without the pale of the bankruptcy law. The temptation to benefit a favorite creditor is apparent. To follow the suggestion that a general assignment should only bear weight when joined with another act of bankruptcy, would in effect mean the abolition of the general assignment as an act of bankruptcy. The presence of the other "act" would in itself be sufficient cause for the filing of an involuntary petition in bankruptcy.

If the general assignment field was left to the states you might have confusion arising from differing state statutory provisions. Probably the provisions would attempt to prefer resident creditors in each state over non-resident creditors. However the act of bankruptcy committed where a preference occurs would still be effective and the victimized creditors could bring the matter over into federal bankruptcy proceedings under this act of bankruptcy.

(2) As we have already noted there are those who consider the Acts of Bankruptcy antiquated. Would it be better to substitute "a general inability to meet current obligations" as a prerequisite for bringing an involuntary petition into a court of bankruptcy?

Before criticizing too strongly the Acts of Bankruptcy it would be well to consider the role they are expected to play. The problem involved is well illustrated, by the author of a book on English Bankruptcy Law, in the following words:

"The task of weaving a mesh coarse enough to let the honest man through, but fine enough to catch the scoundrel has proved to be one of extraordinary difficulty."¹⁶⁹

The "Acts of Bankruptcy" are not the perfect "mesh", but it would appear that they represent a more logical answer to the problem than the equitable insolvency test suggested above. In periods of economic depression it is not uncommon for men to be unable to meet their current obligations. Their "frozen assets" at a fair valuation might well be more than sufficient to pay their debts as they

169. RINGWOOD, *BANKRUPTCY LAW* (17th ed. 1936) 1.

mature. Clearly under this plan the mesh would not be coarse enough to let the honest man through. If, on the other hand, legal insolvency were substituted for the Acts of Bankruptcy, the mesh would not be fine enough to catch the scoundrel. For it would then be possible for a debtor, whose assets exceeded his liabilities at a particular time, to transfer certain possessions to accomplices, so as to preserve them unto himself when in the near future his liabilities exceed his assets. It would seem somewhat harsh to permit momentary insolvency to be the basis for the involuntary petition. The fairer provision would require insolvency for a stated time, but that presents a great burden of proof if it is to rest upon the creditors.

(3) It has been urged that Section 3d should be amended so that the burden of proving solvency would always be on the debtor. This suggestion is not without merit. However, it should be borne in mind that such a change would run contra to one of our firmest rules of evidence, namely that the burden of proof is placed upon the proponent of a legal proposition. The present section places on the debtor the burden of going forward with the evidence through the production of his books, papers, and accounts. In the event he fails to so go forward with the evidence, the burden of proof is placed upon him.

(4) At present a debtor is entitled to a jury trial on the question of his solvency. It has been proposed that the debtor be denied a jury trial in such a case. The suggestion is worthy of adoption, for after all the issue of solvency is best determined by resort to accounting methods.

(5) The element of intent is now an essential factor in determining whether or not certain actions on the part of a debtor constitute a preference and thus an act of bankruptcy. It has been contended that in reality a preference is a preference and intent is difficult to prove. It would appear that this suggestion has some substance and is worthy of Congressional attention. Further, it is to be borne in mind that at present creditors have two helpful presumptions aiding them to sustain the burden imposed upon them. The defendant is presumed to know his own financial condition and he is further presumed to intend the ordinary consequences of his acts.

(6) Unsecured creditors naturally dislike the fact that they must bear the entire burden of administration expenses. They would like to see the secured creditors share their financial obligations. But such a provision could not be retroactive in effect and comply with constitutional requirements. A secured creditor has a right to proceed against the security in order to satisfy the debt owed to him. This having been accomplished, he has little interest in the fate of a fellow creditor, who failed to exact security.

(7) Repeatedly it has been urged that Congress clearly define the "boundary line" between Chapter X and Chapter XI proceedings. Some may claim that the Supreme Court has already done this in its *United States Realty* opinion. However, there is good reason to believe that the Court did not formulate a general rule. Conceding that it did hold that, a large corporation with nine hundred creditors and seven thousand stockholders, could not formulate a plan of arrangement under Chapter XI that would be "fair and equitable", the

question arises as to what is the maximum number of creditors and stockholders that would allow of a "fair and equitable" arrangement. Apparently each debtor will be considered *sui generis* by the courts. Plainly this is a fertile field for Congressional action.

That so many and varied amendments (those listed above represent but a small percentage of the total) have been proposed in the short period that has elapsed since the Chandler Act was passed, is, I believe, indicative not of the inadequacy of the law but rather of the untiring efforts of those who seek to forge the most perfect weapon possible to combat the spread of economic distress.